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MONTHLY NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS
Realty Trust Review

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EARNINGS PER SHARE V. DIVIDENDS: CONFUSION AND UNDERVALUATION

Application of the accounting profession's latest rule on earnings per share calculations is causing much confusion among trust investors. The Accounting Principles Board Opinion No. 15, or simply APB 15, requires trusts and all other companies to report a primary earnings per share number and then a fully-diluted number adjusting for potential dilution from conversion of debentures, exercise of warrants and others.

The confusion arises because many analysts and publications (including this one) base price/earnings ratios upon the fully diluted number. But since trusts must pay out 90% of earnings to shareholders in dividends, the dividend payout is based upon that primary earnings number. Hence some crazy situations have arisen, in which application of a normal P/E ratio to the fully diluted number has made it possible to purchase shares with above-average dividend yield. For instance, **Guardian Mortgage Investors** can be purchased in today's market for about $25, or 13.5 times the 1.84/share fully diluted earnings for its February 1970 year. But Guardian's primary earnings were $2.13/share and the dividend payout was $2.10/share, so that today's price represents about an 8.4% yield. Guardian's first (May) quarter earnings confused the situation even further, with primary earnings being $0.83/share, fully diluted net $0.66, and dividends declared $0.47. When annualized, these numbers mean primary earnings of $3.23, fully diluted net of $2.64, and dividends of $1.88. In our monthly tabulations these translate into a P/E ratio of 9.5 on fully diluted earnings and a dividend yield of 7.5%.

What's going on? The wild gyrations and improbable pricing reflect the fact that Guardian is facing some large near-term conversion of debentures. Under the prevailing rules, GMI had to report earnings on average outstanding shares during its May quarter. But dividends will be paid to record holders on June 30, and holders of most of GMI's 6¼% convertibles have told the trust they will convert to get the higher yield. (At a conversion price of $25, the 40 converted shares would receive dividends at a rate of $1.88 instead of the $1.56 rate as bonds).

Guardian management is happy to get this initial conversion behind because it appears the share prices have suffered because of market confusion. Even with this heavy conversion, which increased shares from about 850,000 to 1.2 million, first quarter earnings of $702,500 compared favorably with the $1.1 million for all of fiscal 1970. On the higher number of shares outstanding, GMI net could approach $2.50 share and the current prices represent a significant undervaluation.

Other trusts with the same problem include **Associated, First** and to a lesser degree North American, which recently absorbed full dilution. Associated has the further problem of paying dividends on cash basis earnings while reporting earnings on an accrual basis, so that dividends lag reported earnings by a wide margin. Here are comparisons for these two, using annualized data for Associated's March quarter and First's fiscal 1970 (January) results:

	First	Associated
EPS-Primary	$1.40	$4.28
–Diluted	1.12	3.12
–Dividend	1.27	2.00
Recent price	21	25½
P/E–Primary	15.0	6.0
–Diluted	18.7	8.2
Indic. yield	6.0	7.8

Actually First's April quarter was at an annual rate of \$1.76 primary and \$1.48 fully diluted. But the dividend of \$0.39 (or \$1.56 annualized) was again somewhere between the primary and diluted earnings, for an indicated yield of about 7.4% on current prices. First has also taken the lead in challenging the manner of applying APB 15 to trust earnings, and in its annual report for January, 1970 gave shareholders two versions of fully diluted earnings: \$1.12 as mandated by APB and \$1.19 as calculated by FMI.

Those Pesky Warrants

FMI argues that the so-called treasury stock method of adjusting for warrants required by APB 15 is unrealistic when applied to its operations. Under the treasury stock method, proceeds from exercise of warrants are to be applied to repurchase shares in the open market – so that EPS would be diluted in proportion to the amount by which current share prices exceed exercise price. In FMI's case, warrant exercise prices of \$11.25 and \$19 are significantly below current quotes of about \$21. Hence FMI told shareholders it considered this method "inappropriate" because "FMI's short-term borrowing practices enable it to apply immediately such proceeds from the exercise of warrants to the retirement of short-term debt, and on this basis net income per share assuming full dilution would have been \$1.19 . . . The presently required reporting procedure under Opinion No. 15 could cause reported earnings per share to be less than earnings distributed to shareholders as dividends."

The rule on warrants is complicated still more by existence of a grandfather's clause which also mandates the treasury stock method in computing primary EPS. Essentially all warrants issued after May 31, 1969 must be included in the primary EPS calculation if exercise is below current prices. However, if the warrants exceed 20% of outstanding shares, then the interest adjustment method (i.e., the reduction in short-term debt path used above by FMI) is used.

The adjustment for warrants becomes important because 17 trusts have issued warrants with their offerings because this was required in the markets of recent months to sell the shares. Of these 17, the warrants of Mortgage Investment Group, North American Mortgage and Republic Mortgage are exempt under the grandfather clause. First's publicly traded \$11.25 warrants are also exempt but its \$19.00 warrants attached to the 5% senior debentures issued in December 1969 are under APB 15. These latter warrants are not detachable at present.

All other warrants listed on page 6 come under APB 15 but since the shares of all these trusts are currently selling at or below exercise price, there is no meaningful change in the primary EPS calculation.

All this comes down to one fact: in a money market environment requiring fancy financial footwork to raise funds, investors will take a long look at capital structure in appraising the quality of current and future earnings per share with annualized dividend payout probably serving as a good substitute for reconciling primary and fully diluted earnings for trusts with wide variations in the two earnings numbers.

In our view, the confusion over these two sets of numbers has penalized market evaluations of Associated, First and Guardian more than other trusts, and hence this trio appears to be relatively more attractive. First at 12.3 times primary earnings and 13.5 times indicated dividend is attractive because its record gives it seasoning with investors. Associated at 8.2 times fully diluted earnings appears to be on the bargain counter, especially since its unaffiliated management gives undivided attention to trust affairs. Guardian's earnings on the higher number of shares should approach \$2.50 for the February 1971 year and the 10 P/E probably understates the leverage this trust can attain through issuance of commercial paper.

CAPITAL MARKETS: CHASE TRUST AND THE FUTURE OF THE CENTABUCK RACE

Now that the \$100 million offering of Chase Manhattan Mortgage and Equity Trust has cleared underwriters, the big question is what happens next in the Centabuck race. For the plain fact is that Chase, one of the nation's top three banks, had to scale back its plans by one third (\$150 million was originally sought). The strategy worked as the offering was oversubscribed with 2.7 million shares and \$45.2 million debentures convertible at \$26.25 sold June 4.

It would be easy to blame the Chase's difficulties on the bleak, even chaotic capital market prevailing when the trust was originally scheduled for a May 18 offering, but we believe that tells only part of

the story. Baldly put, the offering ruffled a lot of feathers among Wall Street's firms because of implications the Chase trust would enjoy priviledges like instant leveraging through commercial paper not enjoyed by other trusts. And when the rumor raced around the Chase trust would get an open credit line with no compensating balances, several trusts who also do business with Chase said that was fine because they would demand the same terms too.

Despite the stone throwing, the final prospectus looked fairly ordinary – if anything with the Rockefeller name can be called ordinary. The trust will have to put up 20% compensating balances for any amounts it uses of a $50 million credit line from the Chase Manhattan Bank, which also acts as adviser. The trust will have to stand on its own two feet in seeking any rating for its commercial paper, with the parent Chase Manhattan Corp. on the sidelines. Initial investments were to include $115 million participations in construction loans from Chase (of which $31 million were to be funded immediately) yielding 11.5% with possible temporary investments in other construction loans to yield an average 9%.

Beyond the details of the offering, any future Centabuck offerings in the Chase manner are likely to run into capital markets clogged by major industrial companies seeking short-term debt. And the trust industry probably still has to face up to the prospect of derivative shareholder suits against lender trusts that are sponsored by other lenders. Obviously the Chase has master advice on this score but the potential for a derivative suit – based on ostensible rather than real conflicts of interests – cannot at all be ruled out.

Still Bank of America has registered its long-awaited BankAmerica Realty Investors, planned as a $135 million offering ($90 million equity, the rest debt). Other new filings include Cousins Mortgage & Equity, seeking a 2.5 million share offering at $20 (total $50 million). The trust is affiliated with Cousins Properties, an OTC company active in real estate development and management, largely through joint ventures.

General Growth Properties, of Des Moines, Iowa, filed a $9 million offering (500,000 shares at $18 maximum). The trust has acquired all the assets and properties of General Management Corp., an investor builder with ten shopping centers, two office buildings and two apartment projects. Matthew and Martin Bucksbaum are principals.

Stadium Realty Trust of Boston proposes a $5 million offering to build a stadium for the Boston Patriots. The football club would use the facility for home games for 30 years. Phil David Fine of Commonwealth Bank in Boston is trust president. Realty Mortgage Investors has withdrawn its proposed offering and trust shares in registration now amount to $1.05 billion.

REALTY TRUSTS NEW AND OLD CONTINUE LISTING PARADE

Both newly organized mortgage trusts and the older equity trusts are flocking to the rosters of the two national stock exchanges. Two arrivals this month illustrate the trend. Connecticut General Mortgage and Realty Investments leaped from initial offering March 17 to NYSE listing June 8, an elapsed time of 82 days. (No record though: Diversified Mortgage did it in 76 days last fall). On the other hand Pennsylvania Real Estate Investment Trust arrived on the ASE June 10, nearly 10 years after its founding in late 1960.

The arrivals bring to 25 the number of listed trust securities, including Republic Mortgage's warrants. Bonds of five trusts are also listed. Other recent listings include Hubbard Real Estate Investment, NYSE, May 18; and First Union Real Estate Equity and Mortgage Inv., May 21, ASE. Waiting in the wings for ASE approval are Alison Mortgage Investment Trust, sponsored by the Los Angeles mortgage banking company of Alison Co., and Atico Mortgage Investors, sponsored by Atico Financial, Miami mortgage banker also listed on the ASE.

While the NYSE generally requires an operating record before accepting listings, it has approved several newly organized trusts including Hubbard, Diversified and ConGen. In these cases the exchange has been moved by sponsorship of groups with demonstrated ability in mortgages and a minimum $100 million in funds for investment. If trust capitalization includes debt, the exchange wants to know if the trust can earn a minimum $2.5 million pretax (really net income for tax-free trusts) after debt service.

The ASE generally looks to the size of the trust and its ability to earn a minimum $300,000 after taxes annually. Since most trusts have over $10 million for investment, even 6% on this amount

51 trusts - avg. yield - 8.7%

Trust (Quoted)	Shares (000)	Book Val.	-Dividend- Last	Ann*	-Latest earnings- Per.	EPS	Ann.*	Cash Flow +	Price 6/18	% Chng.	P/E Ratio	Est. Yield*
Security Mtg.-ASE	3,278	8.77	0.21	0.84	*May Q*	*0.20*	*0.80*	----	11.00	-3.3	7.6 13.8	[illegible]
Sutro Mtg.-ASE	1,734	14.62	*0.35*	*1.40*	Mar.Q	0.33	1.32	----	14.50	-0.9	9.1 11.0	[illegible]
Unionam.MI-OTC	1,255	18.70	0.28	1.12	Feb.Q	0.28i	1.12	----	15.63	+1.7	14.0	7.2
Universal-OTC	1,000	4.34	Div. Susp.		Dec.Y	----	d0.07	----	2.13	+6.3	def.	Nil
U.S. Realty-ASE	2,367	9.96	*0.35*	*1.40*	Mar.Q	0.21	0.84	1.44	x17.13	+3.8	f11.9	8.2
Wachovia MI-WSJ	3,340	18.31	*0.47i*	*1.88*		---			19.25	----	----	9.8
Washington REIT-WSJ	765	8.35	0.20	0.80	Sep.3Q	--	----	0.85	x 8.75	-4.1	f10.3	9.1
Western MI-WSJ	1,000	8.85	0.12	0.48	*MayQ*	*0.14*	*0.56*		4.75	----	8.5	10.1

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WARRANTS

Trust	Exercise terms	Price	Conv. Premium
American Fletcher	$25 - 1/31/75	3 5/8	30.6%
Atico Mtg.	$15 - 12/31/74	2 1/4	39.4
Barnett Mtg.	$20 - 4/1/80	3 7/8	55.3
Cameron-Brown	$25 - 11/15/76	3 7/8	29.1
Capital Mtg.	$20 - 11/25/74	3 1/2	55.3
Citinat. Dev.	$20 - 4/15/75	3	61.4
Citizens Mtg.	$15 - 12/10/74	2 7/8	43.0
City Inv.	$20 - 12/1/74	2 7/8	69.4
First Mtg. Inv.	$11¼ -12/15/77	9 7/8	2.3

Trust	Exercise terms	Price	Conv. Prem.
Midland Mtg.	$12½ - 9/30/74	3 1/4	37.0%
Mobile Home Comm.	$10 - 8/26/74	1 3/4	118.4
Mtg.Inv. Group	$20 - 4/2/74	3 7/8	46.9
Mtg.Inv. Wash.	$15 - 3/5/75	2	52.7
Mtg. Tr. Amer.	$19 - 11/6/74	4 1/2	29.6
No. Amer. Mtg.	$24 - 12/1/74	4	48.3
Republic Mtg.	$20 - 6/30/74	4	60.0
Unionamerica Mtg.	$20. - 12/31/74	3 7/8	52.8

Earnings and dividends reported during the past month are italicized.
*Q-Quarter; H-Half year. Dividends and earnings are annualized by appropriate multiplication of latest quarter without seasonal adjustment. Annualized trust dividends and estimated yields are not to be construed as guaranteed annual rates, since trust dividends depend upon current earnings and are subject to change. +Operating income plus non-cash charges less mortgage amortization. a-Fully diluted. b-Before capital gain of $0.07/sh. c-Bid on stock not traded. d-Defici[illegible] e-Before capital gains of $0.14/sh. f-Based on cash flow as defined. i-Initial quarter, may be less than full 90 days. k-Before capital gain of $0.67/sh. m-For latest fiscal year. NR or NA-Not reported or not available. x-Ex dividend during month. z-Estimated after conversion on June 30. Quotations: Closing prices on listed stocks, bid prices on issues quoted in Wall Street Journal daily (WSJ) or OTC, other over-the-counter issues supplied by William Harman. - Evans & Co., Members NYSE. *Convertibles, pg.4: *Increases to $17 on Feb. 14,1973. **Interest coverage, or ratio of earnings to interest expense. For mortgage trust, net income is added to interest expense and the total dividend by interest expense. For equity trusts, marked ''f'', the ratio denoted cash available to total fixed charges and is the total of net income, depreciation and interest expense, divided by the total of debt amortization and interest expense.*

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